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Having Failed to Defend, an Insurer Can Still Argue Lack of Coverage - Royal Insurance Co. of America v. Kirksville College of Osteopathic Medicine, Inc.

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Having Failed to Defend, an Insurer Can Still Argue Lack of Coverage

Royal Insurance Co. of America v. Kirksville College of Osteopathic Medicine, Inc.[1]

I. INTRODUCTION

When an insurer breaches its contract with an insured party by failing to defend against a claim that could possibly be covered under the policy, the insurer loses several of the rights it otherwise would have enjoyed.[2] Among the rights it loses, however, is not the right to contend in court that the claim was not covered under the terms of the policy.[3] The duty to defend and the duty to indemnify constitute distinct issues, subject to separate trial and independent determination.[4] Such, at least, was the implication of Missouri holdings that drew near to addressing the question.[5]

In recent insurance disputes, however, litigants have attempted to argue that insurance companies in breach of the duty to defend should be entirely precluded from litigating the issue of indemnity and required to pay all losses incurred or settlements reached by insured parties.[6] In *Royal Insurance Co. of America v. Kirksville College of Osteopathic Medicine, Inc.*, the Eighth Circuit Court of Appeals specifically addressed this argument and held that insurers still have the right to be heard on the coverage issue.[7]

This Note explores the consequences of an insurer's breach of the duty to defend under Missouri case law. It also examines the theories applied in other states in support of the position that a breach of the duty to defend entails loss of the right to argue lack of coverage. The Note concludes that the holding in *Royal* resolved a burgeoning controversy by clarifying insurers' rights to an extent unknown in other jurisdictions.

II. FACTS AND HOLDING

The parties between whom the conflict in *Royal* first arose, Lewistown Heet Gas Company and Kirksville College of Osteopathic Medicine, owned adjoining

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1. 304 F.3d 804, 807 (8th Cir. 2002).
2. Whitehead v. Lakeside Hosp. Ass'n, 844 S.W.2d 475, 481 (Mo. Ct. App. 1992).
3. *Royal*, 304 F.3d at 807.
4. *See* Butters v. City of Independence, 513 S.W.2d 418, 425 (Mo. 1974).
5. *See, e.g.*, Esicorp, Inc. v. Liberty Mut. Ins. Co., 193 F.3d 966, 969 (8th Cir. 1999); *Butters*, 513 S.W.2d at 425.
6. *See Royal*, 304 F.3d at 807; Esicorp, Inc. v. Liberty Mut. Ins. Co., 266 F.3d 859, 863-64 (8th Cir. 2001).
7. *Royal*, 304 F.3d at 807.

properties.[8] Lewistown entered into a contract to sell some of its land to Kirksville College for use as a parking lot.[9] Because the land had formerly been the location of a coal gasification plant,[10] coal tar wastes were held in storage containers under the land.[11] Before the date of closing, a contractor hired by the college began constructing the parking lot,[12] and in the course of its work the contractor burst an underground storage tank that held coal tar wastes, causing a release of contaminants.[13] Lewistown brought negligence and trespass claims against the college and its contractor.[14]

Royal, Kirksville College's insurer, initially defended the college under a reservation of rights,[15] but the insurance company withdrew its defense[16] when the United States District Court for the Eastern District of Missouri held that it had no duty to defend the college because of a clause in the comprehensive general liability policies absolutely excluding coverage for pollution claims.[17] The withdrawal proved to be premature: on appeal, the Eighth Circuit held that the exclusion applied to the negligence claim but not to the trespass claim, so the duty to defend on the trespass claim remained.[18]

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8. *Id.* at 805. *See generally Breach of Duty to Defend Does Not Bar Later Litigation of Indemnity Issue:* Royal Ins. Co. of Am. v. Kirksville Coll. of Osteopathic Med., 23 No. 6 ANDREWS HAZARDOUS WASTE LITIG. REP. 13 (2002).

9. *Royal*, 304 F.3d at 806.

10. *Id.*

11. Coal gas is produced at gasification plants using a carbureted water gas process. By reacting coal or coke with steam, a gas rich in hydrogen and carbon monoxide is produced, which is called coal gas. Adding petroleum oils to the coal gas increases its heating value. By means of a carburetion process, the coal gas is then thermally broken down into gaseous constituents. The resulting product is known as carbureted water gas. In these operations, coal tar sludge, iron oxide wastes, and associated coal gasification wastes are generated. The tar sludge is usually deposited in on-site pits, drainage ditches, or underground storage containers. *See* Public Health Assessment, Fairfield Coal Gasification Plant, Fairfield, Jefferson County, Iowa, *available at* http://www.atsdr.cdc.gov/HAC/PHA/fair/fcg_p1.html.

12. *Royal*, 304 F.3d at 806.

13. *Id.*

14. *Id.*

15. *Id.* When coverage is in doubt, the insurer may offer to defend the insured under a reservation of rights agreement. In such an agreement, the insurer reserves to itself all of its policy defenses in case the insured is found liable. A reservation of rights is thus a means by which the insurer seeks to suspend the operation of estoppel through a non-waiver agreement prior to determination of the liability of the insured. *See* Apex Mut. Ins. Co. v. Christner, 240 N.E.2d 742, 747 (Ill. App. Ct. 1968).

16. *Royal*, 304 F.3d at 806.

17. Royal Ins. Co. of Am. v. Kirksville Coll. of Osteopathic Med., Inc., 191 F.3d 959, 960 (8th Cir. 1999).

18. *Id.* at 964.

Lewistown's claims against Kirksville College and the contractor were eventually settled.[19] The state court that heard the action had granted summary judgment for the contractor, holding that the contractor had implied permission to work on the site and thus no trespass had occurred.[20] Meanwhile, Lewistown and Kirksville College reached a settlement in which the college agreed to complete its purchase of the property for $30,000, pay damages of $270,000 for the reduction in value to the property, and to assume responsibility for any environmental remediation.[21] The three parties to the state action (Royal having already withdrawn) then agreed to stipulate to a dismissal of all claims with prejudice.[22]

Although Royal settled with the college for the failure to defend,[23] Royal continued to argue that it was not required by the insurance policies to indemnify the college for claims arising from this type of incident.[24] Rather, the college contended that not only was the insurance company required to provide a defense, but it should also be punished for its failure to litigate by being prohibited from arguing it had no duty to indemnify.[25] The district court agreed with Royal and granted summary judgment in its favor. First, the court held, Royal's duty to indemnify only extended to the claim for trespass, and thus not to the damages arising under the negligence claim. Second, the college was collaterally estopped from claiming damages for the trespass by the state court's ruling that the contractor had implied permission to work at the site.[26]

The district court's decision was affirmed by the Eighth Circuit.[27] Judge Loken found that by failing to defend the lawsuit, Royal lost its ability to reject what it might consider an unfavorable settlement reached by the insured party without Royal's input.[28] Royal, however, was entitled to litigate the issue of indemnity,[29] that is, whether the policies required compensation for such claims in the first place. Thus, the court of appeals expressly established the rule of law that when an insurer breaches its duty to defend an insured party, the insurer is not prohibited from contesting whether it must indemnify the insured under the terms of the policy.[30]

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19. *See Royal*, 304 F.3d at 806.
20. *Id.*
21. *Id.*
22. *Id.*
23. *Id.* at 805.
24. *Id.* at 805-06.
25. *Id.* at 807.
26. *Id.* at 806.
27. *Id.* at 809.
28. *Id.* at 806-07.
29. *Id.* at 807.
30. *Id.*

III. LEGAL BACKGROUND

Fundamental to the holding in this case is the established principle that when an insurer breaches its duty to defend, it loses the ability to contest any settlement reached by the insured acting on its own behalf.[31] In effect, therefore, the breach releases the insured party from any contractual obligation not to settle, and the insured may proceed to obtain the best settlement it can while retaining the right to be compensated by the insurer.[32] The insurer generally need only provide compensation for those portions of the settlement obligation that are actually covered by the liability policy.[33]

The risks that face an insurer declining to defend against third party claims are explored in *Whitehead v. Lakeside Hospital Ass'n*,[34] a case relied on by the *Royal* court. In *Whitehead*, the parents of a child who suffered brain damage at birth brought a malpractice claim against Lakeside Hospital in February of 1989.[35] The hospital's insurance policy, however, required that in order for coverage to apply, the claim had to be filed during the coverage period, essentially the calendar year 1987.[36] The insurance company denied coverage but provided a defense under a reservation of rights.[37] The company thereafter repeatedly sought to intervene to stay proceedings while a petition was pending for declaratory judgment that the claims were not covered by the policy.[38]

In upholding the lower court's denial of the insurer's petitions to intervene, the court held that, on the one hand, an insurer cannot insist on controlling the defense in a case and at the same time reserve the right to disclaim coverage.[39] On the other hand, the court explained, an insurer exposes itself to certain risks by refusing to defend in full on the ground that the claim is outside the coverage of the policy.[40] If the claim is not covered under the policy, the insurer avoids liability, but if the claim falls within the policy coverage, the refusal of the insurer to defend the insured is unjustified and the insurer has breached its contract.[41] The consequences of such a breach include the loss of the right to

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31. *Id.* at 806-07; *see also* Whitehead v. Lakeside Hosp. Ass'n, 844 S.W.2d 475, 480 (Mo. Ct. App. 1992); Cologna v. Farmers & Merchants Ins. Co., 785 S.W.2d 691, 701 (Mo. Ct. App. 1990).

32. *Whitehead*, 844 S.W.2d at 480.

33. *Royal*, 304 F.3d at 806-07.

34. *See Whitehead*, 844 S.W.2d at 481.

35. *Id.* at 477.

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.* at 480.

40. *Id.* at 481.

41. *Id.* The legal losses of rights suffered by the insurer upon unjustifiably refusing to defend are classed in four categories: (1) the insurer takes on new positive obligations;

demand that the insured comply with certain contractual provisions, including the contractual obligation not to settle.[42] The insured therefore may proceed to settlement and achieve a reasonable compromise while retaining its ability to receive compensation from the insurer.[43]

In light of the burdens imposed by these risks and compromised rights, Missouri courts have described the insurer's duty to defend as one that is more broad than the duty to indemnify.[44] The duty to defend is broader because it arises whenever there is merely a possibility of liability under the facts as known at the outset of the case in their widest applications, while the duty to indemnify is limited to actual obligations under the more narrow terms of the contract.[45] This approach can be explained on the grounds that the duty to defend would be a "hollow promise" if the insured were required first to prove that the claim would be covered before receiving a defense against the claim.[46] It is, after all, at trial that the determination is made whether the claim is valid, and when coverage is disputed, whether the policy covers it.

The Missouri Supreme Court recently clarified this principle in *McCormack Baron Management Services, Inc. v. American Guarantee and Liability Insurance Co.*[47] In *McCormack*, a security guard complained to his supervisor that a new employee of the security service often missed work or came to work intoxicated.[48] The supervisor showed the letter to the property manager of the housing project that engaged the security service, and the property manager responded that the security guard's complaint amounted to insubordination.[49] When the security guard was fired from his job, he sued the property management company for tortious interference with a contractual relationship based on the property manager's remarks, claiming that his loss of employment

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(2) the insurer loses some positive rights previously enjoyed, such as the right to control the defense; (3) the insurer loses the right to demand compliance by the insured with certain prohibitory provisions in the policy; and (4) the insurer loses the right to demand compliance by the insured with certain affirmative provisions in the policy. *Id.*; *see also* 4 LEE R. RUSS, COUCH ON INSURANCE §§ 51:44-51:67, at 51-78–51-116 (3d ed. 1996).

42. *Whitehead*, 844 S.W.2d at 480.

43. *Id.*

44. Royal Ins. Co. of Am. v. Kirksville Coll. of Osteopathic Med., Inc., 304 F.3d 804, 808 (8th Cir. 2002); *see also* Esicorp, Inc. v. Liberty Mut. Ins. Co., 193 F.3d 966, 969 (8th Cir. 1999); McCormack Baron Mgmt. Servs., Inc. v. Am. Guarantee & Liab. Ins. Co., 989 S.W.2d 168, 171 (Mo. 1999); *cf.* Butters v. City of Independence, 513 S.W.2d 418, 424 (1974).

45. *McCormack*, 989 S.W.2d at 170.

46. *Id.* (citing 13 JOHN A. APPLEMAN & JEAN APPLEMAN, INSURANCE LAW AND PRACTICE § 4684 (1976)).

47. *Id.* at 173-74.

48. *Id.* at 169.

49. *Id.*

was a direct result of those statements.[50] The issue, then, was whether the property management company's insurance policy, which covered damages resulting from personal injury, covered this claim when the definition of personal injury included such "offenses" as "injury, other than 'bodily injury,' arising out of . . . [o]ral or written publication of material that slanders or . . . disparages a person's . . . services."[51]

American Guarantee, the property management company's insurer, denied coverage and refused to provide a defense.[52] At trial, the insurer took the position that because the term "disparages" was used in the policy under the heading of "offenses," the policy only covered the cause of action of "disparagement" or "injurious falsehood," and did not cover the tortious interference claim.[53] While the claim against the insurer for failure to indemnify was not decided by the court because it was not ripe for judgment at the time of trial, the court was nonetheless able to hold that the insurer had a duty to defend against the claim.[54] Applying the meaning of "disparage" as it would be used by an ordinary person of average understanding, the court found that the manager's comments had certainly disparaged the guard's services.[55] Since the term "offense" did not limit the policy to any particular cause of action[56] the court held that at least the possibility for a valid claim was present, and the insurer thus had a duty to defend.[57] "If the complaint merely alleges facts that give rise to a claim potentially within the policy's coverage," the court held, "the insurer has a duty to defend."[58]

In previous Missouri case law, however, breaching the duty to defend had not necessarily resulted in the insurer's loss of its right to dispute coverage.[59] Earlier Missouri cases demonstrate that it is at least possible that an insurer may be allowed to argue the issue of coverage despite having failed to defend the insured.[60] *Butters v. City of Independence*,[61] for example, involved claims arising from an injury sustained when a crane operator allowed a crane to come in contact with high voltage power lines, causing severe electrical shock to an

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50. *Id.*
51. *Id.* at 170.
52. *Id.*
53. *Id.* at 171.
54. *Id.* at 174.
55. *Id.* at 171.
56. *Id.*
57. *Id.* at 174.
58. *Id.* at 170-71 (citing Butters v. City of Independence, 513 S.W.2d 418, 424 (Mo. 1974)).
59. *See generally* Whitehead v. Lakeside Hosp. Ass'n, 844 S.W.2d 475, 480-81 (Mo. Ct. App. 1992).
60. *See, e.g., Butters*, 513 S.W.2d at 425.
61. *Id.*

employee on the ground.[62] The insurer insisted on defending the claim under a reservation of rights—a demand deemed unacceptable by the municipal policy holder.[63] The claim had gone to trial even as the insurance company still refused to defend unless its rights were reserved.[64] The trial court determined that such behavior amounted to a breach of the duty to defend,[65] and treated the coverage issue summarily, holding that the claims were covered.[66] The court of appeals ultimately reversed, holding that the insurer should have been allowed a hearing.[67] The consequences of the breach specifically included loss of the insurer's right to control the defense and the release of the insured from the prohibition against incurring expenses and settling claims, but the question of coverage was appropriate for remand.[68]

The holding in *Butters* thus implied that the two kinds of duties, to defend and to indemnify, are distinct and separately triable.[69] This principle was also stated in the abstract in *Esicorp, Inc. v. Liberty Mutual Insurance Co.*,[70] which served as a primary precedent in support of the holding in *Royal*.[71] In *Esicorp*, welded steel pipe sections shipped from St. Louis for use in a California construction project were negligently inspected.[72] The construction contractor sued the inspection firm when it became apparent after the pipes were in place that the welding along the length of the pipes contained rejectable defects.[73] As the insured party, the inspection firm took advantage of its right under a Missouri statute to agree separately with the plaintiff that the plaintiff would only collect any settlement obligation or damages from the insurer.[74] The insurer, however, denied coverage and refused to provide a defense against the claim because, in its view, the defective welding did not constitute "property damage" under the terms of the policy.[75]

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62. *Id.* at 420-21.
63. *Id.* at 421-22.
64. *Id.* at 424.
65. *Id.*
66. *Id.* at 425.
67. *Id.*
68. *Id.*
69. *See generally id. See also* Esicorp, Inc. v. Liberty Mut. Ins. Co., 193 F.3d 966, 969 (8th Cir. 1999).
70. *Esicorp*, 193 F.3d at 969.
71. *See* Royal Ins. Co. of Am. v. Kirksville Coll. of Osteopathic Med., Inc., 304 F.3d 804, 807 (8th Cir. 2002).
72. *Esicorp*, 193 F.3d at 968.
73. *Id.*
74. *Id.*; *see also* MO. REV. STAT. § 537.065 (2001); *Esicorp*,193 F.3d at 971. Note that the insured parties in *Butters* and *Whitehead* used this same procedure. *Butters*, 513 S.W.2d at 422; Whitehead v. Lakeside Hosp. Ass'n, 844 S.W.2d 475, 477 (Mo. Ct. App. 1992).
75. *Esicorp*, 193 F.3d at 969.

The court held that under the broad scope of the duty to defend, the faulty welding on the pipes could potentially fall within the policy's coverage of "property damage," and the insurer therefore was in breach.[76] The court emphasized that because the duty to defend is a contractual obligation, damages such as paying the insured's cost of defending the underlying action must flow from the breach.[77] By failing to defend, however, the insurer had lost the rights to control the defense and contest the settlement, unless the insured and the plaintiff reached the settlement in collusion or bad faith.[78] The crucial issue addressed by the court, in light of the development of case law with regard to breaching the duty to defend, was whether such a breach creates insurer liability for portions of the settlement not in fact attributable to claims covered under the policy.[79] If claims not otherwise covered under the policy could be charged to the insurer as part of a settlement agreement, the mere failure to defend the insured party would have the effect of substantially expanding the insurer's duty to indemnify.[80]

Citing *Butters*, the court held that no such expansion of the duty to indemnify resulted.[81] This conclusion in part was based on an inference deduced from the *Butters* court's decision to grant the insurer in that case a trial on the issue of coverage.[82] According to the court, Missouri law required that when an insured reached a settlement with a plaintiff, the settlement should be analyzed to discover whether the underlying claims actually qualified under the policy, since the insurer's liability could not exceed the policy's scope.[83]

Indeed, subsequent events in the *Esicorp* litigation reveal that in practice, the duty to defend may exist when the duty to indemnify is entirely absent.[84] On remand, the district court held that the claims for negligent inspection of the welding constituted "property damage" and were covered under the policy's terms. On appeal, the Eighth Circuit reversed, holding that most of the damages could not be classified as "property damage" at all and therefore were not covered by the policy in the first place.[85] Thus, although a potential claim had existed and the insurance company had a duty to defend against it,[86] ultimately the company's initial determination that the claim was not covered proved to be

76. *Id.* at 970.
77. *Id.*
78. *Id.*
79. *Id.*
80. *See id.* at 970-71.
81. *Id.*
82. *Id.* at 971.
83. *Id.*
84. *See* Esicorp, Inc. v. Liberty Mut. Ins. Co., 266 F.3d 859, 861 (8th Cir. 2001).
85. *Id.*
86. *Esicorp*, 193 F.3d at 970.

substantially correct and there was no duty to indemnify the main body of the claims addressed in the settlement.[87]

IV. INSTANT DECISION

In *Royal*, the court found that the insured, Kirksville College, was entitled to settle with the plaintiff, Lewistown, because the college's insurer, Royal, had breached its duty to defend.[88] It noted the college's contention that Royal should be punished for its refusal to defend by being precluded from litigating the issue of indemnity under the policy.[89] The court emphasized that this issue was highly significant because the duty to defend arises when there is only a potential for coverage.[90] But the court found that only one of the claims asserted against the college was actually covered.[91] The majority held, as in the *Esicorp* decisions,[92] that a settlement incorporating multiple claims must be analyzed to determine whether each of the claims it covers qualifies for indemnity, and the insurer is only liable to pay the portion attributable to the qualifying claims.[93] The court therefore concluded that despite having breached its duty to defend, an insurer is not only permitted but is entitled to a trial of the indemnity issue.[94]

In a partial dissent, Judge Bye concurred that Royal had breached its duty to defend the college.[95] He also agreed that Royal was entitled to apportionment of the settlement between covered and non-covered claims.[96] Judge Bye dissented, however, from the majority's position that the college was collaterally estopped from claiming indemnity for the trespass claim, which the lower court held was covered by the policy.[97] Although the state court held that no trespass had occurred, this determination was not made known to the parties until after they had entered a settlement agreement in which the trespass claim had almost certainly been a factor.[98] The judge noted that the college entered this settlement

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87. *Esicorp*, 266 F.3d at 863. The court did hold that there was damage to the epoxy coating in the pipes that could be labeled "property damage" and attributed to the insured's negligence. *Id.* at 863. The value of this covered claim, however, was $11,298, *id.*, approximately one-third of one percent of the total damages sought, $3,046,709.

88. Royal Ins. Co. of Am. v. Kirksville Coll. of Osteopathic Med., Inc., 304 F.3d 804, 806 (8th Cir. 2002).

89. *Id.* at 806-07.

90. *Id.* at 807.

91. *Id.*

92. *Id.*

93. *Id.*

94. *Id.*

95. *Id.* at 809 (Bye, J., concurring in part & dissenting in part).

96. *Id.* (Bye, J., concurring in part & dissenting in part).

97. *Id.* (Bye, J., concurring in part & dissenting in part).

98. *Id.* (Bye, J., concurring in part & dissenting in part).

after being unjustifiably abandoned by Royal.[99] Judge Bye therefore concluded that in determining the insurer's duty to indemnify the court should focus on the status of the claim at the time of settlement.[100]

V. COMMENT

Royal at last clearly stated in general terms a principle that had been approached, and in some cases was implicit, in previous Missouri holdings: that a breach of the duty to defend cannot alone deprive an insurer of its right to a trial on the issue of coverage under the policy.[101] The case therefore serves as a capstone in the line of Missouri cases relating to the consequences of breach of the duty to defend, and brings Missouri insurance law one step ahead of other jurisdictions in clarity on the subject of insurers' rights.

The *McCormack* case summarized the law concerning when a duty to defend arises, but did not reach the issue of indemnity.[102] Likewise, *Esicorp* held that despite having breached its duty to defend, the insurer in that case was required to compensate the insured for very little of the damages actually claimed since only a small fraction was actually covered by the policy.[103] But in failing to declare the general principle that an unjustified refusal to defend does not result in loss of the right to litigate indemnity, these cases left open the possibility that future parties would assert that a loss of the right to argue against indemnity could be applied as a penalty. By stating the principle outright, the *Royal* decision is likely to curtail such punitive arguments.

Punitive arguments are not without support in the case law of other jurisdictions, however.[104] Some courts have employed contract law theory to expand an insurer's liability upon breach of the duty to defend to cover even losses outside the policies. These courts have held that an insurer is liable to pay the full amount of a settlement or judgment against the insured when the settlement or judgment is reasonably foreseeable as a consequence of the breach.[105] For example, in *Amato v. Mercury Casualty Co.*,[106] an insurer was held liable for a default judgment entered against the insured. Although in *Amato* the final analysis revealed that the claims were in fact not covered by the

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99. *Id.* (Bye, J., concurring in part & dissenting in part).

100. *Id.* (Bye, J., concurring in part & dissenting in part).

101. *Id.* at 807.

102. McCormack Baron Mgmt. Servs., Inc. v. Am. Guarantee & Liab. Ins. Co., 989 S.W.2d 168, 173 (Mo. 1999).

103. Esicorp, Inc. v. Liberty Mut. Ins. Co., 266 F.3d 859, 863-64 (8th Cir. 2001).

104. *See generally* PHIL L. BRUNER & PATRICK J. O'CONNOR, JR., BRUNER AND O'CONNOR ON CONSTRUCTION LAW § 11:24 (2002).

105. *See id.*; Comunale v. Traders & Gen. Ins. Co., 328 P.2d 198 (1958); Amato v. Mercury Cas. Co., 61 Cal. Rptr. 2d 909 (Cal. Ct. App. 1997).

106. *Amato*, 61 Cal. Rptr. 2d at 909.

policy, the default judgment would not have been entered if the insurer had defended.[107]

Other courts have found full liability in tort or under equitable principles.[108] Kansas courts have held that the doctrine of equitable estoppel could be applied to prohibit an insurer's use of a coverage defense.[109] The courts in that state stopped short, however, of creating a bright-line rule that insurers who reserve their rights or fail to provide a defense are always equitably estopped from raising a defense based on coverage.[110] According to the court in *Aselco, Inc. v. Hartford Insurance Group*, such an approach has been adopted by only a minority of jurisdictions, in part because of the "potential of creating coverage where none [existed]."[111] Thus, although the court found that there may be sound public policy grounds for holding that the insurer could no longer try the indemnity issue,[112] the Kansas court left the matter unresolved. It held that in light of previous Kansas cases where the indemnity issue was disputed even after breach of the duty to defend, there was no basis for finding that Kansas law denied an insurer its right to argue against coverage.[113]

Illinois courts do not hesitate to apply the doctrine of estoppel.[114] Presumably to prevent abuse and ensure that parties perform their obligations under policy contracts, Illinois law requires that when coverage is uncertain an insurer must provide a defense. The insurer may choose between reserving its rights or pursuing a simultaneous action seeking a declaratory judgment that there is no coverage.[115] If it fails to act on either of these alternatives, the insurer will be estopped from raising any defense on the basis of coverage under the policy.[116]

Interpreting California law, the Ninth Circuit has held that under a well-established general rule "an insurer that wrongfully refuses to defend is liable on

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107. *Id.* at 911.

108. BRUNER & O'CONNOR, JR., *supra* note 104, § 11:24.

109. *See* Aselco, Inc. v. Hartford Ins. Group, 21 P.3d 1011, 1020 (Kan. Ct. App. 2001). The court in *Aselco* described three possible consequences for breach of the duty to defend, but chose not to endorse the third. The three consequences are: (1) an insurer could be held liable for damages in excess of the stated policy limits, (2) collateral estoppel could prevent the insurer from litigating issues that were litigated and determined in the underlying action, and (3) equitable estoppel could prevent the insurer from raising any defense of lack of coverage. *Id.* at 1019-20.

110. *Id.* at 1020.

111. *Id.*

112. *Id.*

113. *Id.*

114. Korte Constr. Co. v. Am. States Ins., 750 N.E.2d 764, 769-70 (Ill. App. Ct. 2001).

115. State Farm Fire & Cas. Co. v. Martin, 710 N.E.2d 1228, 1231 (Ill. 1999).

116. *Id.*

the judgment against the insured."[117] An insurer could not validly assert the defense that ultimate judgment was not rendered on a theory within the coverage of the insurance policy.[118] If the insurer were permitted to argue that the judgment would have been smaller had the insurer not failed to defend, an impossible burden would be imposed on the insured to prove the extent of the loss incurred by the insurer's breach.[119]

In Missouri case law as well, estoppel has long been the preferred theory in the hands of the insured when the insurer, by inordinate delay or utter refusal to defend, breaches its duty yet attempts to argue the indemnity issue.[120] Arguably then, the doctrines of waiver and estoppel can under some circumstances still be used in Missouri to create coverage that did not previously exist.[121] To invoke the rule of waiver, the Missouri Supreme Court in *Brown v. State Farm Mutual Automobile Insurance Co.* required nothing more than a showing of prejudice.[122] In the absence of prejudice, a showing either that the insurer expressly waived the immunity or engaged in conduct that clearly and unequivocally showed an intention to waive the contractual right would accomplish the same purpose.[123] Abandonment of the insured in the face of a claim might alone satisfy the prejudice requirement of such a test.

The partial dissenting opinion by Judge Bye also would expand insurers' liability to cover claims that are foreign to the terms of their policies, if perhaps not to the extent of requiring full liability.[124] Judge Bye would only impose this requirement when abandonment by the insurer caused the insured to enter into a settlement that included a non-covered claim.[125] Still, this position has the potential of greatly expanding insurer liability without so much as a hearing on the issue of coverage.

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117. Pershing Park Villas Homeowners Ass'n v. United Pac. Ins. Co., 219 F.3d 895, 901 (9th Cir. 2000) (quoting Gray v. Zurich Ins. Co., 419 P.2d 168, 179 (Cal. 1966)).

118. *Id.*

119. *Id.* at 902.

120. Macalco, Inc. v. Gulf Ins. Co., 550 S.W.2d 883, 891-92 (Mo. Ct. App. 1977). *See generally* Jeremy P. Drummond, Note, *When Will the Smoke Clear?: Application of Waiver and Estoppel in Insurance Law*, 66 MO. L. REV. 225 (2001).

121. *See* Drummond, *supra* note 120, at 245.

122. Brown v. State Farm Mut. Auto. Ins. Co., 776 S.W.2d 384, 388 (Mo. 1989); *see* Drummond, *supra* note 120, at 245-46.

123. *Brown*, 776 S.W.2d at 388. Although waiver and estoppel theoretically can create coverage in Missouri where none existed under policy terms, the burdens of proof for waiver and estoppel are almost impossible to satisfy in practice. Drummond, *supra* note 120, at 245-46.

124. *See* Royal Ins. Co. of Am. v. Kirksville Coll. of Osteopathic Med., Inc., 304 F.3d 804, 809 (8th Cir. 2002).

125. *See id.*

VI. CONCLUSION

Contrary to the waiver and estoppel approaches and the views of Judge Bye, the majority position in *Royal* tends to reject the imposition of coverage liability where none existed under the applicable policy. In this way, the decision is more in harmony with the trend established in the earlier Missouri cases, *Butters*,[126] *Whitehead*,[127] and *Esicorp*,[128] and the predominant position among the states. Because earlier holdings had established that the duty to defend and to indemnify are in fact separate,[129] logic dictates that the analysis for each should be separate at trial. Thus, the holding in *Royal* constitutes a culmination of previous decisions in which questions of indemnity were remanded for consideration despite an insurer's breach of the duty to defend. Just as under Kansas insurance law the right to litigate indemnity in these circumstances had been established by implication, but not yet resolved as a matter of certainty,[130] Missouri case law before *Royal* contained a troublesome ambiguity. In this decision, an insurer's right to litigate issues of indemnity in Missouri became much more certain through a clear statement of a fundamental principle embracing a majority position.[131]

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126. Butters v. City of Independence, 513 S.W.2d 418, 425 (Mo. 1974).

127. Whitehead v. Lakeside Hosp. Ass'n, 844 S.W.2d 475, 481 (Mo. Ct. App. 1992).

128. Esicorp, Inc. v. Liberty Mut. Ins. Co., 193 F.3d 966, 863-64 (8th Cir. 1999).

129. *Id.* at 969.

130. Aselco, Inc. v. Hartford Ins. Group, 21 P.3d 1011, 1020 (2001).

131. *Id.*